

SALT Cap Workaround

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Pass-Through Entity Tax/SALT Cap Workaround

- Proposal: Creates an optional pass-through entity tax that allows PTE businesses to deduct more than the Tax Cuts and Jobs Act's limit of \$10,000 in state and local taxes.
 - **If structured properly, reduces taxes for Vermonters while *gaining* state revenue**
 - Allowable by IRS Notice IRS Notice 2020-74
- Current Vermont law: VT currently only allows this for non-residents and composite filers, creating a disadvantage for resident PTE owners.
- Revenue Impact
 - JFO estimates this as a \$10-\$20 million federal tax cut for Vermont business owners.
 - The Governor's recommended model of this policy is estimated to generate additional state base revenue of \$500,000

No Pass-Through Entity Tax

- \$1 million in S-Corp income
- \$0 PTE tax paid
- \$1 million Federal K1 distribution
- SALT Deduction Cap of \$10,000

~\$300,000 paid in federal taxes

~\$80,000 paid in state taxes

Pass-Through Entity Tax

- \$1 million in S-Corp income
- \$76,000 PTE tax paid
- PTE tax fully deductible at entity level
- \$924,000 Federal K1 distribution

~\$275,000 paid in federal taxes (Savings = \$25,000)

~\$73,000 paid in state taxes (Savings = \$7,000)

Problem

State loses \$7,000 from this taxpayer if we give them a full credit for pass-through entity taxes paid.



Solution

Offer a Personal Income Tax credit of 90 cents for each \$1 of pass-through entity taxes paid.

Pass-Through Entity Tax

- \$1 million in S-Corpincome
- \$76,000 in PTE tax
- \$924,000 Federal K1 distribution
- \$68,400 credit for PTE taxes paid
- About \$275,000 paid in federal taxes
 - Federal savings of \$25,000
- About \$81,000 paid in state taxes
 - State taxes increase ~\$1,000
- Taxpayer still makes the election due to federal savings

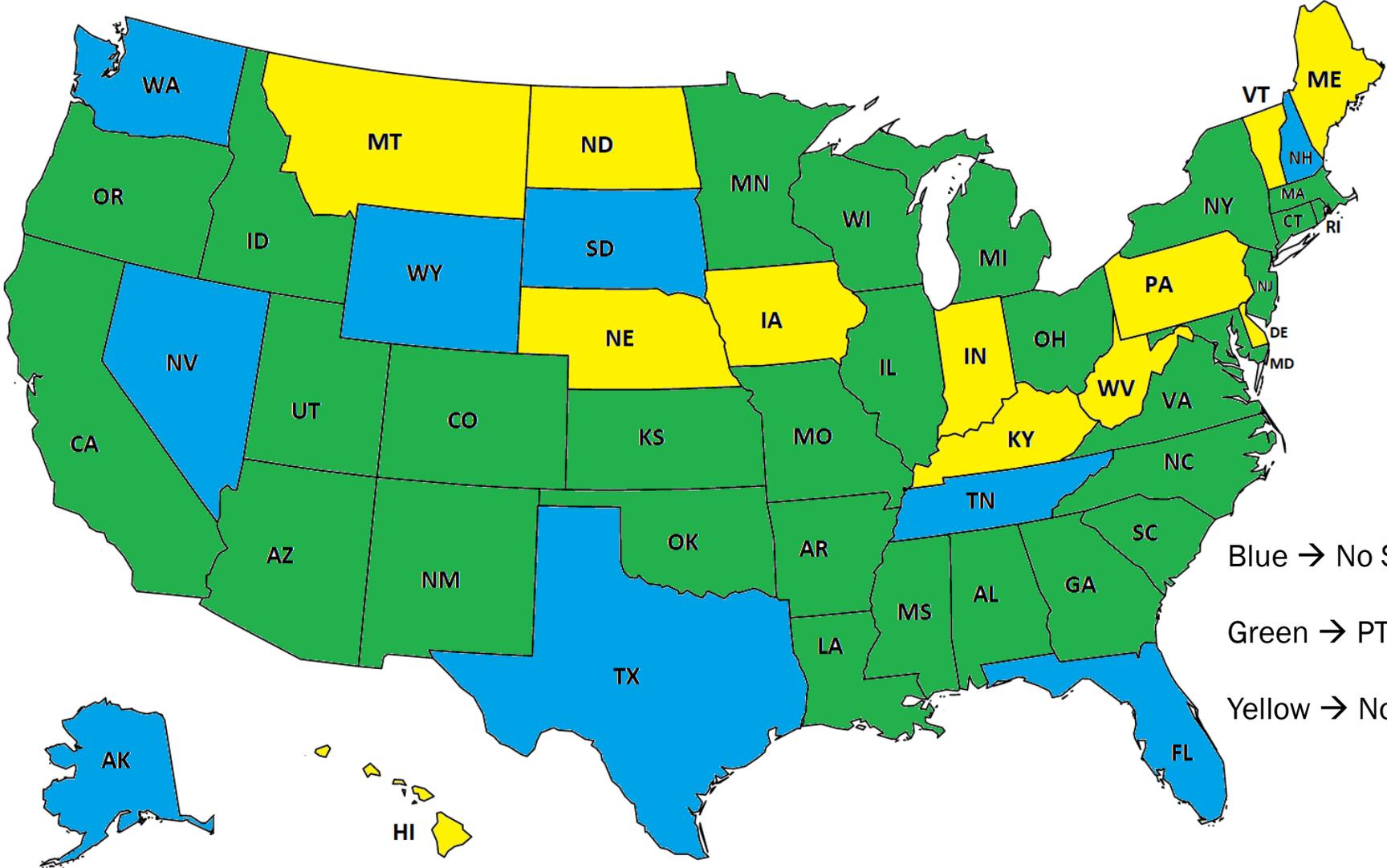
As a taxpayer's PTE income increases, their state tax liability increases, but they have a lower overall tax bill

How?

For each additional \$1 of PTE tax paid, the taxpayer:

- Gains at most \$.0875 of reduced state taxes (highest rate in VT 8.75%)
- Loses \$.10 because of the 90% credit (VT nets \$.0125)
- Gains likely between \$.24 and \$.37 of reduced federal taxes

Pass-Through Entity Tax/SALT Cap Workaround Map



Blue → No State Income Tax
Green → PTE Tax Enacted
Yellow → No PTE Tax

Pass-Through Entity Tax/SALT Cap Workaround (Continued)

- Administrative aids:
 - Elective
 - Only allowed for PTEs where all shareholders/members/partners are individuals, businesses can't qualify with C-Corp or other PTE owners.
 - All owners must elect the same treatment
- This structure also allows Vermont resident owners of out of state PTEs to take advantage of another state's PTE tax.